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SUBJECT: SLOWER COLOMBIAN ECONOMY IN 2008 AMID INFLATION
AND PESO PRESSURES

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¶B. (B) BOGOTA 2053

¶1. (SBU) SUMMARY: A slowing global economy, rising inflation and currency appreciation are now expected to drag Colombia's economy down from its average of over 7 percent in 2006-07 to less than 5 percent in 2008. Many business leaders and GOC officials including President Uribe blame the Central Bank's interest rate policy for much of the slowdown, though more nuanced observers acknowledge broader economic forces at play and contend that Colombia is returning to a more sustainable growth rate for the longer term. While questionable solutions to address rising prices and slowing growth, such as price controls, export subsidies, and dollarization of Colombia's economy, have surfaced, the GOC remains committed to increasing investment, liberalizing trade relations, and continuing sound macro-economic policies. END SUMMARY.

Signs of Slowdown Growing...

¶2. (SBU) According to the Colombian Business Climate poll of 1,232 Colombian businesspeople conducted by Datexco in early July, for the first time in eight years the majority of those polled said the GOC should focus on the economy as its top priority above security and other issues. The results echo a broader Gallup poll of Colombian citizens (ref A) and signal not only the Uribe Administration's success in improving security, but also growing worry about a weakening economy. Businesspeople that participated in the Datexco poll cited decreases in industrial capacity utilization (77 percent compared to 82 percent in same period of 2007), slower growth in consumer demand (4 percent versus 7.5 percent in 2007), and increasing debt as worrisome signs of a slowdown in the Colombian economy.

¶3. (SBU) Beyond falling confidence levels, Colombia registered a meager 1.2 percent growth in production in the first half of 2008 according to the National Association of Industries (ANDI) and GDP growth of 4.1 percent during the same period. Meanwhile, new construction starts in Bogota (Colombia's largest construction market) fell 46 percent compared to 2007, with declines in most other major markets around the country as well. Beatriz Uribe, President of Colombia's Construction Chamber (Camacol) told us a saturation of the market from years of strong construction growth and higher interest rates were to blame.

...As Central Bank Fights Inflation, but Fuels Peso

4, (SBU) In spite of the slowing economy, steady increases in food and fuel costs continue to spur inflation well beyond the Central Bank's 2008 target of 4 percent. Following months of rising inflation figures, on July 25, the Central Bank raised its benchmark interest rate 25 basis points to a seven-year high of 10 percent in an effort to control creeping inflation. Nevertheless, most local economists believe that inflation will reach 7.5 percent for 2008--almost double the target and one percent higher than ¶2007.

¶5. (SBU) Meanwhile, the rate increases have widened the gap between Colombian rates and U.S. rates attracting foreign portfolio investment and pushing the Colombian peso higher against the U.S. dollar. The inflow of foreign currency has led to the introduction of capital controls (ref B) and propelled a 13 percent appreciation of the Colombian Peso against the U.S. dollar in 2008. The peso's rise has significantly harmed the price competitiveness of the Colombian export sector employing thousands of workers, including the banana, cut flower, coffee and textile industries.

Growth Estimates Slide

¶6. (U) Optimists began the year predicting GDP growth above 6 percent, but Colombian banks, economic thinktanks and the government have now begun revising 2008 GDP growth estimates downward to between 4 and 5 percent. While the GOC official

estimate has only come down from 5.3 percent to 5 percent, the independent Central Bank lowered its estimate to 4.3 percent, blaming the economic slowdown on strikes in various sectors, a reduction in infrastructure projects, and higher prices for raw materials, rather than high interest rates.

¶7. (SBU) Jorge Londono, President of Bancolombia, Colombia's largest bank, told us he expects GDP growth to total 4.5 percent for 2008 and said that the GOC has been "too emotional" about the peso's fluctuation while ignoring the keys to sustaining long term growth such as infrastructure investment. Londono dismissed concerns of a significant downturn in the economy and said that the 2008 growth rate actually was returning to a more sustainable level than the frothy expansionary rates of 2006-07. Sergio Clavijo, President of the National Association of Financial Institutions (ANIF), echoed Londono's analyis, telling us that he believes Colombian economy's growth rate cannot exceed 5 percent for more than short bursts, such as 2006-07, until structural reforms are made on taxes, pensions, and labor law.

Both Frustration and Ideas Welling Up

¶8. (U) Much of the private sector and GOC, nevertheless, have focused blame on the Central Bank as Colombia's high-flying economy has begun to cool. In public remarks the day after the July 25 rate hike, President Uribe accused the Central Bank of "throwing gasoline" on Colombia's economic challenges by reducing consumption, job creation, and growth. Similarly, export industry associations such as bananas and flowers criticized the rate increase and resulting peso appreciation as a further erosion of their competitiveness. Finally, Colombian Members of Congress have scheduled hearings in the Senate for Central Bank President Jose Dario Uribe to explain why the Bank has not met inflation targets the last three years and to justify the latest rate increase.

¶9. (SBU) In an effort to respond to concerns about the economy, politicians and business leaders have offered up an increasing number of ideas to limit the impact of inflation and the peso's appreciation. For example, Senator Gabriel Zapata, a member of the pro-Uribe Administration legislative coalition, has introduced legislation to substitute the

Colombian Peso with the U.S. dollar as the national currency. Pointing to lower inflation and interest rates in Panama, El Salvador and Ecuador where dollarization has taken place, Zapata says his proposal would avoid the exchange rate fluctuations that have hurt Colombian exporters. Nevertheless, Central Bank President Uribe and business leaders such as Juan Pablo Cordoba, President of the Colombian Stock Exchange (BVC), have publicly dismissed the idea of dollarization as a solution to the current dilemma.

¶10. (SBU) President Uribe dedicated the majority of his July 20 address to Congress to concerns about the economy, suggesting increased subsidies for export industries and public investment despite a persistent fiscal deficit that has bolstered inflation. Likewise, Agriculture Minister Arias has suggested that the GOC implement price controls for food and other products, which would mark a significant step away from the Uribe Administration's steady efforts to liberalize the Colombian economy since 2002. Bancolombia President Londono expressed concern to us about such populist economic ideas that the GOC had floated in recent months, but said he remained confident that the Uribe Administration would not do serious harm to Colombia's market economy.

A Bright Side Still Remains

¶11. (SBU) Despite facing external and policy challenges, the Colombian economy remains well positioned to continue growing between 4 and 5 percent into 2009. Trade Minister Plata announced August 7 at the ANDI national assembly that foreign direct investment was on pace to reach USD 11 billion in 2008, a record for Colombia. Likewise, the GOC recently trimmed over 1 percent (approximately USD 800 million) of its 2008 budget which should help contain its fiscal deficit and reduce inflationary pressures. Finally, the GOC's gains in security, its steps to open the economy to foreign trade, and its increasing public investment all serve to reinforce the Colombian economy's competitiveness and ability to weather immediate challenges such as the peso's appreciation and inflation.
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